REPORT AND RECOMMENDATION
OF THE
PRESIDENT
TO THE
EXECUTIVE DIRECTORS
ON A
PROPOSED LOAN
TO
KOSOVSKA BANKA PRISTINA
WITH THE GUARANTEE OF
THE SOCIALIST FEDERAL REPUBLIC OF YUGOSLAVIA
FOR A
THIRD INDUSTRIAL CREDIT PROJECT
June 26, 1978
CURRENCY EQUIVALENTS*

<table>
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<th>Currency Unit</th>
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<th>Yugoslav Dinar (Din.)</th>
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<tr>
<td>US$1</td>
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<td>Din. 18.00</td>
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*The Yugoslav Dinar has been floating since July 13, 1973, as of December 31, 1977, the rate was Din. 18.4452=$1.

FISCAL YEAR

January 1 - December 31

GLOSSARY OF ABBREVIATIONS

PBS – Privredna Banka Sarajevo
SBS – Stopanska Banka Skopje
IBT – Investicione Banka Titograd
KBP – Kosovska Banka Pristina
BOAL – Basic Organization of Associated Labor
DFC – Development Finance Company
DRs – Developed Regions (of Yugoslavia)
ERR – Economic Rate of Return
FRR – Financial Rate of Return
GMP – Gross Material Product
Kosovo – Socialist Autonomous Province of Kosovo
LDRs – Less Developed Regions (of Yugoslavia)
SDK – Sluzba Drustvenog Knjigovodstva or Social Accounting Service
YUGOSLAVIA: THIRD INDUSTRIAL CREDIT PROJECT

Summary of Loan and Project

Borrower: Kosovska Banka Pristina (KBP)

Guarantor: Socialist Federal Republic of Yugoslavia

Amount: US$40 million equivalent in various currencies.

Beneficiary: Small- and medium-sized industrial enterprises in Kosovo.

Terms: The loan would bear interest at 7.5 percent per annum. Repayment would be according to schedules reflecting the composite amortization schedules of the sub-loans financed.

On-lending Terms: Individual sub-loans would be repaid over a period not exceeding 15 years from the date the Loan Agreements are signed including grace periods of normally up to three years, and in case of foreign co-financing up to five years. KBP would on-lend the proceeds at 11 percent per annum with the sub-borrowers carrying the foreign exchange risk.

Project Description: Of the $40 million loan, US$5.0 million equivalent would be on-lent to help finance the foreign exchange cost of imported equipment for investments in industrial sub-projects with a labor-intensive orientation (defined as projects creating employment at a maximum cost per job of $23,000 equivalent); US$14.7 million equivalent would be on-lent for the same purpose to small- and medium-size industrial sub-projects (but without the specific labor-intensive emphasis); US$20.0 million equivalent would be on-lent for the same purpose to three "special" large "projects" already tentatively identified which have special developmental significance for Kosovo; and US$300,000 equivalent would be used to help finance the foreign exchange cost of technical assistance (mainly foreign consultants) for KBP and its industrial clients, all in the Autonomous Province of Kosovo, the poorest region of Yugoslavia.

Sub-projects with total cost exceeding US$10 million equivalent will have to meet a cost per job criterion (US$40,000 per job or less); in addition, while the

1/ While these projects are likely to be the largest financed under the proposed loan, they are still smaller than typical projects that attract direct Bank lending.

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appropriateness of international competitive bidding (ICB) should be considered for all foreign procurement, any individual contract to be financed in whole or in part with Bank funds for imported goods that is expected to exceed US$2.0 million equivalent will be a candidate for procurement under ICB. If KBP and its sub-borrower decide that ICB is not appropriate, this decision must be justified satisfactorily to the Bank before the sub-project will be considered as eligible for Bank financing.

**Final Date for Sub-project Submissions:**
June 30, 1981

**Free Limit:**
US$1.0 million for individual small- and medium-size and labor-intensive sub-projects up to an aggregate of 60 percent of that portion of the KBP Loan allocated to normal individual small- and medium-size and labor-intensive sub-projects, the large "projects" and technical assistance being excluded.

**Estimated Disbursements:**

<table>
<thead>
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<th>Calendar Year</th>
<th>1979</th>
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<td>6.0</td>
<td>25.5</td>
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**Staff Appraisal Report:**
Report Number 1865a-YU, dated June 23, 1978
EMENA Projects Department
1. I submit the following report and recommendation on a proposed loan, equivalent to US$40.0 million, to Kosovska Banka Pristina (KBP), with the guarantee of the Socialist Federal Republic of Yugoslavia, to help finance the foreign exchange costs of investments in medium- and small-size and labor-intensive industrial projects as well as technical assistance and pre-selected larger projects especially responsive to the needs of Kosovo, the country's poorest region. The loan would bear interest at 7.5 percent per annum and would be repaid according to schedules reflecting the composite amortization schedules of the subloans financed. Individual subloans will be repaid over a period not exceeding 15 years from date of signing including grace periods of normally up to three years and in case of foreign co-financing (para 63, this Report), up to five years.

PART I - THE ECONOMY 1/


Economic Trends and Development Issues

3. The economic development of Yugoslavia over the past two decades has been impressive, characterized by rapid growth accompanied by dynamic structural and institutional changes. GDP grew in real terms (1972 prices) at an average annual rate of about 7 percent and, given an average population growth rate of one percent per year, real per capita income more than tripled.

1/ Part I of this report is identical to that in the Report and Recommendation of the President for a Middle Neretva Hydro Power Project (Report No. P-2242a-YU) dated April 19, 1978.
In 1976, per capita GNP was estimated at $1,680 (World Bank Atlas Methodology). The activity of the social sector, especially industry, was the driving force of the economy and the share of industry in GDP increased from about 23 percent in 1955 to about 32 percent in 1976, and paved the way for the development of a modern industry/service oriented urban society.

4. The population growth rate which averaged 1 percent per year during the last two decades, however, varies considerably among the regions ranging from an average rate of 1.6 percent for the less developed Republics and Provinces (LDRs) to 0.7 percent for the developed ones (DRs). Structural changes in the economy have permitted a sizeable transfer of the labor force from agriculture to industry and services. Despite this, by 1975, 39 percent of the employed resident labor force was still engaged in agriculture and forestry, mostly on small private farms; industry (including mining) accounted for 24 percent, and other sectors for 37 percent.

5. The socio-political framework evolved through several constitutional amendments which were consolidated in the new Constitution of 1974. It strengthens three important features of the socio-political system of Yugoslavia. First, self-management, whereby the use and control of the socially owned means of production are entrusted to the workers' collectives, is the fundamental right and obligation of every Basic Organization of Associated Labor (BOAL—the smallest identifiable unit of production which produces a marketable output) in every sector and activity. Second, the responsibility for most important social and policy decisions is shifted from the Federation down to the Republics and Provinces, and on to the communes. And third, the management and financial responsibility for social activities (health, education, welfare, etc.) is transferred from the realm of the state to Communities of Interest (decision-making bodies which comprise delegates of both suppliers and users of the specific services). Responsibility for certain economic activities affecting large segments of the society (like communal services, power production, highways and water management) is progressively similarly organized through Communities of Interest.

6. The social sector, which includes government, enterprises and public institutions such as libraries, hospitals, theatres and schools, has the leading role in economic and social development. It accounts for 85 percent of GDP and employs over half of the total labor force. The private sector is comprised predominantly of peasant farms (generally with a 10 hectare limit to land holdings) and small enterprises (generally with a 5-person limit on the number of nonfamily workers), mainly in handicrafts, construction, trade, transport and tourism. In the past, the private sector had been relatively neglected by government policy. However, lately increased attention is being devoted to private farmers with a view to accelerating the growth of agricultural production and reducing the rural/urban income disparity. New legislation has also been enacted to promote private business through the pooling of resources in joint ventures with social sector enterprises or among private small-scale industrial, transport, trade or other entities. These measures aim to encourage private sector productive investment and employment, by circumventing the 5-employee limitation, and to absorb the returning migrant workers and mobilize their savings.
Regional income disparity—with a gradient of per capita income falling generally from North to South—is one of the most important development issues facing the country. Four regions can be distinguished by stage of development. The Republic of Slovenia is the high per capita income region with incomes almost double the national average. The Republics of Serbia and Croatia and the Autonomous Province of Vojvodina make up the middle income regions, with incomes ranging from 100 to 125 percent of the national average. However, even within these regions there are pockets of underdevelopment, which basically coincide with private sector agriculture. The Republics of Bosnia-Herzegovina, Montenegro and Macedonia, with per capita incomes about two-thirds of the national average, constitute the upper group among the officially designated less developed regions. The Socialist Autonomous Province of Kosovo (Kosovo), with an average per capita income of only 30 percent of the national average (about US$500.0 equivalent for 1976), is the least developed region. These interregional disparities can be traced back further to intra-regional disparities. Within Republics and Provinces the per capita income spread between communes can extend over the range of 10 to 1, and it is the prevalence of stagnating poor rural communes within the LDRs which largely determines the disparity between the regions. The rate of economic growth of the LDRs as a whole was only slightly below the average for Yugoslavia, but due to the faster population growth (1.6 percent per year versus 0.7 percent in the DRs) the income disparity had until recently tended to widen. In order to reverse the trend and to accelerate economic growth and social development in the LDRs, mechanisms were instituted for sizeable transfers of financial resources, initially on a non-returnable basis. Since 1971, net credits on highly favorable terms (containing a grant element of around 50 percent) were made available to the LDRs through the Federal Fund for the Accelerated Development of Less Developed Regions, equivalent to about 20 percent of their total investment in the social sector. These transfers amounted to about US$430 million equivalent in 1976 in addition to about US$250 million equivalent being transferred as budgetary grants for social services. The mechanism for both categories assures a growth of transfers in line with the growth in GDP.

The rate of open unemployment to the total resident labor force amounts to about 5 percent but understates the magnitude of the employment generation problem because of the existence of large reserves of rural underemployed and the need to employ returning migrant workers. The rate of registered unemployment to social sector employment averaging about 11.9 percent for the country as a whole in 1976 is perhaps a better measure. A rapid growth of the social sector which provides more productive employment is, therefore, imperative if the natural increase of the labor force, in addition to the returning migrants, is to be absorbed and the ranks of the unemployed

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1/ In Yugoslavia, unemployment is measured in terms of registered job seekers actually unemployed as well as those employed but seeking new jobs.
reduced. This problem takes on added urgency as the incidence of unemploy-
ment 1/ is highly regionalized ranging from 25.4 percent at one extreme in
Kosovo to 1.5 percent in Slovenia.

Recent Developments

9. In 1975, the growth rate of the economy receded to 4.5 percent, fol-
lowing the rapid increase of GDP of 9 percent in the previous year. This was
due mainly to the combined effects of a restrictive monetary policy, stagnat-
ing exports and a reduced growth of personal incomes and leveling consump-
tion; economic investment and housing construction provided the major growth
stimulus during 1975. The inflationary pressure, which built up during 1974
and extended into 1975, receded drastically in the second half of the year;
the rate of increase of industrial producer prices decreased from 30 percent
for 1974 to 22 percent in 1975, and the index of real personal receipts stag-
nated for the whole of the year. The good harvest in 1974 had a favorable
impact on the balance of payments, although meat exports were severely affected
by the European Community ban on meat imports. Exports to oil producing coun-
tries and to the non-convertible currency area continued to expand rapidly
in 1975, but were insufficient to compensate for the sharp decline in exports
to the convertible currency area. As a result, commodity exports declined
by 2 percent in real terms. Workers' remittances and receipts from tourism
increased marginally. However, a larger contraction of imports and an
improvement in the terms of trade led to some decline in the current account
deficit to $1.0 billion as compared to $1.2 billion in 1974.

10. Further reduction of the balance of payments deficit and of the
inflationary pressures in the economy were the major objectives of economic
policy during 1976. As compared to a nominal increase of 22 percent in 1975,
GDP grew by 14 percent in nominal and 4 percent in real terms in 1976. Fol-
lowing a near stagnation of industrial production (and economic activity in
general) in the first half of the year—as a result of the implementation
of new legislation enforcing greater financial discipline on enterprises—
industrial growth picked up in the second half of the year and recorded a rise
of about 4 percent. The combination of the economic slack and price policy
resulted in a cutback in the rise of producer prices and the cost of living to
less than 10 percent, i.e. less than half the previous year's increases.
Favorable results were also realized in the field of foreign trade. The
marked deceleration of inflation, the slackening of domestic demand and the
revival of Western European demand, as well as foreign trade policy, resulted
in a 20 percent growth of merchandise exports and about 4 percent decline of
imports in nominal terms. The reduced balance of trade deficit was also
aided by the inflow on account of invisibles, resulting in a $150 million
balance of payments surplus for the year. Foreign exchange reserves also
reached a record of over $2.0 billion. Social sector employment grew by
3.7 percent and allowed the absorption of some returning migrant workers yet,
with the realized GDP growth rate, this meant a virtual stagnation of average
workers' productivity for the year.

1/ Ratio of registered unemployment to social sector employment.
Estimates for 1977 and Prospects for 1978

11. Although initial projections for 1977 envisaged a moderate GDP growth rate of about 5.5 percent and a balance of payments deficit of some $500 million, estimates for the year indicate both a higher economic growth rate and balance of payments deficit than expected. The pick-up of economic activity which started in the second half of 1976 continued into 1977 with industrial production growing at a rate of about 10 percent in the first half of the year. The large monetary expansion in 1976 also enabled the expansion of investment and other components of domestic demand and resulted in a somewhat higher inflation rate than anticipated (cost of living rise of 13-15 percent). For the year as a whole, GDP is estimated to have risen by almost 7 percent with industry growing by 8 percent and agriculture by 4 percent. Employment is estimated to have grown by about 3.5 percent and average workers' productivity at an almost equal rate. The most significant deviation, however, occurred in the foreign trade sector. As a result of the slow growth of exports and the fast growing imports connected with expanding industrial production, which was not compensated for by the growth of invisibles including workers' remittances, the balance of payments deficit for 1977 is expected to amount to $1.3 billion matching that for 1974. The country was able to contract the necessary foreign financing in 1977, however, maintaining its external reserves at about the previous year's level. The program for 1978 envisages the stabilization of the economic growth rate of 6-7 percent, a reduction of the inflation rate and a major consolidation of the foreign trade sector to improve the balance of payments position.

Medium- and Long-Term Objectives and Prospects

12. The surfacing of major economic problems during 1974, such as high international inflation and balance of payments pressures, led to a reappraisal of development objectives. More emphasis was to be given to the development of Yugoslavia's own natural resources, with the development of the energy sector as the highest priority. The focus is on electric power, where the generating capacity is falling critically short of the rapidly rising power requirements of the expanding economy. The development of the power sector will be based primarily on the largely unutilized hydropower potential and soft-coal reserves of the country. Other priority activities are ferrous metallurgy, some segments of non-ferrous metallurgy (notably lead, zinc, copper, nickel and bauxite/aluminum), technologically advanced production equipment, basic chemicals including petroleum refining, agriculture and food processing, interrepublic transportation, multipurpose works, and housing and basic construction material.

13. This emphasis on accelerated development of the raw material basis and of the economic infrastructure requires a more capital-intensive investment pattern, associated with longer time lags between investment and output. To sustain this development path, both continued high borrowing abroad and an increased savings rate will be essential. Since, with the possible exception of private savings, interest rates have not been given a significant role to play in the determination of the level of aggregate savings, the
income policy—i.e. the guidelines governing the distribution of enterprise income between workers' income and accumulation—will have to play a crucial role.

14. The new Five Year Plan (1976-80) focuses on the implementation of these objectives. For GDP growth, an average rate of 7 percent per year is proposed, compared with a target growth rate of the previous Plan of 7.5 percent and a realized growth rate of 6.5 percent. For employment, the average planned growth rate would come to about 3 percent with annual increments exceeding the natural increase of the labor force by growing margins. This would permit more vigorous pursuit of two major social objectives: the reduction of the number of temporary migrants abroad (estimated at about 900,000 in 1975), and an increased absorption of the rural underemployed into the social sector, which is likely to have significant impact only in the DRs. The economy will continue to be open to the world market, although the composition of foreign trade is expected to change with a reduced share for raw material and semi-finished products on the import side, and an increased share for agricultural products and manufactured goods on the export side. Workers' remittances are not expected to increase in real terms, but rising tourism receipts and construction work abroad are expected to compensate for the expected declining importance of workers' remittances.

15. The reduction of regional disparities is another priority objective of the new Five Year Plan. To that end, the mechanisms for the transfer of financial resources to the LDRs in the form of loans at concessionary terms for economic investment and of budgetary grants for social development will be continued, with some marginal increase in contributions as a proportion of GDP. Since most of the natural resources of the country, including hydro-power, are to be found in the LDRs, these regions will also benefit from the increased emphasis on the development of power and basic industries which will be financed jointly through direct financial contributions from the consuming regions.

16. The new Five Year Plan was prepared according to the self-management principle stipulated in the Constitution of 1974. Self-management planning is perceived as an iterative process of sequential, converging consensus-finding. In the initial stage, broad priorities (as to sectors and activities) and general quantitative targets and constraints (like growth rates of social product and the volume of savings and investment) are determined on the basis of consensus by the Assemblies of the socio-political communities (Governments at the Communal, Republican and Provincial, and Federal levels). Subsequently, the planning process starts at the bottom with individual enterprises and Communities of Interest setting out expectations and targets. The planning process then proceeds through successive and partially overlapping stages of horizontal adjustments within sectors and branches (aimed primarily at eliminating gross duplications), vertical adjustments between closely inter-dependent sectors and branches (aimed at determining realistic orders of magnitudes of production, conceptually within an input/output framework), and regional adjustments between Republics and Provinces (aimed at both horizontal and vertical consolidation). The socio-political communities participate in
this process by ensuring observance of the broad priorities, targets and constraints, and by resolving conflicts which cannot be resolved by the direct participants. The evolving consolidated programs of action, which in their totality constitute the operational portion of the Plan, are codified in the form of "Social Compacts" 1/ or "Self-Management Agreements" 2/ which are legally binding for the whole Plan period unless renegotiated in the case of major deviations occurring in the course of Plan implementation. The new Plan differs from the previous one in strengthening and formalizing the commitments for implementation by enterprises, banks and government institutions.

Creditworthiness

17. In spite of the recent balance of payments problems, the prospects for Yugoslavia's continued economic growth during the next decade are good. The country's endowment of natural and human resources, its relatively low dependence on imported primary energy, its pragmatic approach to economic problems and its readiness to undertake institutional changes, combine to give grounds for a favorable assessment of future prospects. Yugoslavia will need to continue to raise foreign capital on a fairly large scale, mostly from established channels such as the Euro-currency market, suppliers' credits and the World Bank. In addition, greater use may be made of credit lines from COMECON countries and the European Community, and efforts are being intensified to open up new sources of capital in OPEC countries. The debt service ratio is estimated to have risen in 1976 (around 18 percent), but it is expected to level at about 17 percent in 1977 and subsequent years. Taking into account Yugoslavia's debt service record and the measures taken in the past to control balance of payments problems, as well as the prospective growth of production and structural improvement of the balance of trade, Yugoslavia remains creditworthy for a substantial amount of Bank lending.

PART II - BANK GROUP OPERATIONS IN YUGOSLAVIA 3/

18. The Bank has made 47 loans to Yugoslavia totalling about US$1,808 million. Of this amount, approximately 47 percent (US$856.4 million) has been for 17 loans for the transportation sector—9 for highways, 5 for railways, and one each for a natural gas pipeline, an oil pipeline, and a port project.

1/ "Social Compacts" regulate broader economic issues or policies and are concluded among Socio-Political Communities and also involving Economic Chambers and Associations of Enterprises and Trade Unions.

2/ "Self-Management Agreements" are more specific and regulate most relations, rights and obligations within, among and between economic organizations like BOALs, enterprises and banks.

3/ Substantially unchanged from Part II of the President's Report for a Middle Neretva Hydro Power Project (Report No. P-2242a-YU) of April 19, 1978.
Bank lending has generally concentrated on infrastructure including, in addition to the transportation loans, four power loans, one telecommunications loan, two water supply and sewerage and five multipurpose loans. Five loans totalling US$206 million (about 11 percent of the total amount lent to Yugoslavia) have been made for agriculture and agro-industries. Ten loans amounting to US$200 million (about 11 percent of the total) have also been made for industry and two for tourism amounting to US$30 million. The $27 million first Bank loan for air pollution control was approved May 25, 1976. In addition, IFC has made investments in eleven Yugoslav enterprises totalling about US$155 million. Annex II contains a summary statement of Bank Loans and IFC investments as of April 30, 1978 and notes on the execution of on-going projects.

19. The interrelated objectives which the Bank has pursued in its lending to Yugoslavia remain essentially unchanged. These objectives are:

(a) to support Yugoslav efforts to address the critical issues of regional disparities and unemployment;

(b) to promote agricultural development in both the individual farmer and social sectors by providing basic infrastructure and credit facilities;

(c) to encourage structural reforms in the major sectors through improved coordination, institution-building and technical assistance;

(d) to help in identifying and financing gaps in basic infrastructure—particularly transport and energy; and

(e) to alleviate critical shortages of convertible foreign exchange by providing part of the required long-term capital, encouraging and promoting Yugoslavia's efforts to tap other sources of medium- and long-term capital, and supporting projects which generate or conserve foreign exchange.

It is obvious that each and every Bank operation cannot address all these objectives nor be entirely oriented towards the welfare of the less developed regions (LDRs), but the basic thrust of the Bank's activities in Yugoslavia has increasingly been towards the development of the LDRs and the agricultural sector in particular.

20. The Bank's emphasis on assuring the accelerated development of the LDRs is fully in accord with the Federal Government's avowed policy to narrow the gap between the richest and the poorest regions. The new development Plan assigns even higher priority to redressing such disparity, and to that end the Federal Government has now obtained consensus of its constituents, not only on the channeling of domestic resources to the LDRs through the Federal Fund mechanism (see para. 7 of this Report) but also on the distribution of external resources including Bank lending. The Bank has actively cooperated with the Government in evolving a distribution pattern for Bank lending which gives weight to the income levels and population size of particular regions and has
on this basis over the last three years effectively directed more than two-thirds of its lending to the LDRs. While the Bank's ability to achieve such a distribution is clearly influenced by the ability of the regions to generate viable projects, recent experience in bringing forward well designed and economically sound projects for the LDRs is cause for confidence in our ability to maintain the level of Bank activity in the LDRs, though there will undoubtedly be year-to-year fluctuations.

21. In recognition of the fact that such an expanded investment program for the LDRs would need to be preceded by a systematic survey of these regions to take stock of development potential and identify constraints, the Bank undertook and completed economic surveys of the four LDRs (Kosovo, Bosnia-Herzegovina, Macedonia and Montenegro). These regional surveys, coupled with intensified Bank assistance in project formulation and ongoing economic and sector analysis, reinforce the impact of the Bank's participation in the development of these regions.

22. Over the past several years, more than two-thirds of our lending, as noted in paragraph 20 above, has been to the LDRs. Operations, such as the proposed third industrial credit project (which is submitted concurrently with a proposed fourth industrial credit project designed to benefit three of the other LDRs), as well as operations envisaged for LDRs over the next two years, including loans for irrigation, water supply and sewerage and multipurpose water resource and agricultural development, emphasize our continuing orientation to the needs of the LDRs. Recently approved loans for a Ninth Highway Project, a Fifth Railway Project and a Middle Neretva Hydro Power Project as well as the Second Power Transmission Project approved in 1977, will both assist the LDRs and promote structural reforms in the transport and energy sectors. IFC is currently investigating several new investment opportunities to encourage joint ventures which would provide technical, management and marketing expertise as well as long-term capital.

23. The Bank helped formulate the 1973 "Green Plan", a comprehensive framework for agricultural development, which recognized the need to encourage the role of the individual, low-income sector (which holds almost 85 percent of the cultivated land and employs over 90 percent of the farm population). As a follow-up, the 1976 "Green Plan" calls for even greater attention to agriculture and clearly recognizes that the impetus for accelerated growth must necessarily be derived from the underexploited resources of the individual farming sector. It is now generally appreciated that the individual farmer sector can generate significant increases in production if provided with sufficient support in terms of extension services, credit for inputs and basic infrastructural facilities. The loans for the Ibar Multipurpose Project (Loan No. 777-YU) and the Metohija Multipurpose Project (Loan No. 1360-YU) in Kosovo, the first and second Agro-Industries Projects (Loan Nos. 894-YU and 1371-YU) in Macedonia, and the first and second Agricultural Credit Projects (Loan Nos. 1129-YU and 1477-YU, respectively), have given special attention to the needs of the individual farmer sector.

24. The agricultural sector deserves attention for a number of developmental considerations. It is the obvious vehicle for addressing the problems
of rural poverty which underlies regional disparity; it can provide opportunities for productively employing the rural population, thus reducing the pressure for creating non-agricultural employment; and it contributes to reducing reliance on imports and improving the prospects for exports of food and other agricultural products. Forthcoming projects for irrigation and rural development will support agriculture development in general and in particular, the individual farmer sector.

25. Decentralized management, which is the cornerstone of Yugoslavia's socio-economic philosophy, adds to the inherent difficulties involved in formulating coherent sector plans. One of the principal features of the 1974 constitutional changes and subsequent legislation, however, has been to revamp the institutional framework and to introduce mechanisms for coordination. The new system of self-management planning requires that the programs of all enterprises are discussed, negotiated and reflected in legally binding agreements. In order to support these efforts for improved coordination, the Bank intends to pursue vigorously the initiatives it has sponsored in terms of establishing the basis for evolving coherent sector policies.

26. Given the complexity of the Yugoslav system, which requires reaching a consensus of all parties affected by any substantive decision, the process of dealing with problems and of evolving acceptable solutions is cumbersome. The Bank sees it important, however, to continue exerting its influence in shaping the policy framework and having a further beneficial impact on fostering coordination, particularly in the power and transport sectors where significant progress has already been achieved. For instance, the Eighth Highway Project (Loan No. 1377-YU) approved March 15, 1977, provides for studies of road-user charges and railway costs which the Government and we believe essential for developing intermodal coordination and devising a policy framework for the transport sector. The Second Power Transmission Project (Loan No. 1469-YU approved June 28, 1977), an extension of the interconnected transmission system, partly financed by the Bank in 1972 (Loan No. 836-YU), will considerably extend the supply of power throughout the country and thereby encourage power exchange coordination among all republics/provinces. The promise of further progress in the coming years is reassuring and additional improvements in sector coordination and policy are foreseen in conjunction with upcoming projects.

27. A persistent foreign resource gap looms as the major impediment to Yugoslavia's ability to maintain its growth momentum and ability to address the critical issues of unemployment and regional disparities. While the Yugoslavs are making concerted efforts to open up and enlarge access to Western financial markets and institutions (including the European Investment Bank), there is no concrete evidence of substantial additional inflows. The Bank, therefore, remains a major source of long-term external capital for the foreseeable future, and its significant level of operations in Yugoslavia not only constitutes the largest source of long-term external capital but, equally important, is regarded by international financing institutions as evidence of international confidence in Yugoslavia's economic performance, policies and prospects. In financing of infrastructure as well as industrial and agro-industrial projects, we continue to devote particular attention to possibilities for attracting co-financing. In our support of projects in the directly
productive sectors, we have and will continue to devote attention to those which generate or conserve foreign exchange.

28. Yugoslavia's debt to the Bank amounts to about one-fifth of its total public debt, outstanding and disbursed. The outstanding debt to the Bank is, however, expected to decline gradually from its current level to about 10 percent of Yugoslavia's total external debt. Service on Bank loans as a proportion of total debt service was 4 percent in 1976 and is projected to increase to about 5 percent by 1980.

PART III - THE INDUSTRIAL AND FINANCIAL SECTORS 1/

A. The Industrial Sector

The Role of Industry

29. Industry has been the principal engine of Yugoslavia's impressive economic growth since 1954; it has opened up the country to the world economy and provided employment to the growing labor force. The industrial value added growth rate of 9.4 percent per annum during 1956-75 exceeded the GMP 2/ growth rate of 7.2 percent per annum (in 1972 prices), resulting in an increase in the share of industry in GMP from 23 percent in 1955 to 37 percent in 1976. In the same period, industrial investment grew at a rate of about 7 percent in real terms, accounting for around one-half of total social sector investment; industrial exports, which grew at 10.3 percent per annum, accounted for about 90 percent of total commodity exports by 1975; industrial employment grew at the rate of 5 percent per annum compared to the social sector employment growth rate of 4 percent per annum. Industry now accounts for 39 percent of total social sector employment. Gains in productivity were noteworthy during the same time span, averaging 5 percent per annum. The performance of the industrial sector in the 1971-75 Plan period was consistent with the past record; the 8.1 percent per annum growth rate of industrial production equalled the Plan target.

Structure of Industry

30. Generally, Yugoslavia's industrial enterprises are large. Small-scale industrial establishments (defined as those employing less than 200

1/ Part III of this Report is identical to Part III of the Report and Recommendation of the President for a Fourth Industrial Credit Project (Report No. P-2360-YU) dated June 26, 1978 which is being circulated concurrently to the Executive Directors.

2/ Gross Material Product or Social Product excludes "non-productive" (in Yugoslav terminology) services such as education, health, administration, defense and other public services. GDP is approximately 14 percent higher than GMP.
workers and having fixed assets of less than 30 million Dinars or $1.7 million equivalent) constituted only 18 percent of the total industrial establishment and accounted for only 2.3 percent of total industrial fixed assets and 3.1 percent of total industrial employment in 1974. The preponderance of large establishments is the result of the past industrialization policy: the emphasis placed on energy production and exploitation of existing natural resources and the attempt to build up processing facilities based on newly exploited natural resources. In 1974 basic industries, namely energy (electricity, coal and petroleum), ferrous and non-ferrous metals, chemicals and pulp and paper, accounted for 53 percent of industrial fixed assets but only 34 percent of industrial value added and 20 percent of industrial employment. In contrast, other industries, such as non-metallic minerals, metal products, shipbuilding, electrical products, building materials, wood products, textiles, leather and footwear, rubber products, food products, and printing and publishing, accounted for only 47 percent of industrial fixed assets but 66 percent of industrial value added and 80 percent of industrial employment. This reveals not only the domination of basic industries in the industrial structure, but also their relatively higher capital-output and capital-labor ratios.

31. The Less Developed Regions (LDRs). Over the past 20 years, the share of industry in GMP in the four LDRs grew faster than in the other regions. Though the LDRs started with a considerably lower share of industry in GMP after the Second World War, by 1975 the share was 37.3 percent in the LDRs compared to 36.8 percent in the developed regions (DRs). Bosnia-Herzegovina had the highest share of the four LDRs, with almost 40 percent, and Montenegro the lowest with 31.2 percent in 1975. The LDRs, more than the rest of Yugoslavia, have considerable wealth of natural resources in mining and energy. Basic industry (including mining) was, therefore, given top priority. This strategy was aimed at providing power, minerals and raw materials for processing industries in Yugoslavia, mainly located in DRs, and for export. Moreover, compared with the requirements of promoting light industries, basic industries were expected to economize on scarce management, technical and marketing expertise. Mining and production of basic metals now play an important role in the four LDRs. Approximately half of Yugoslavia's total steel capacity is located in Bosnia-Herzegovina, Montenegro and Macedonia. Considerable deposits of bauxite have enabled a rapid expansion of the aluminum industry, centered in Bosnia-Herzegovina and Montenegro, which produces aluminum for domestic use and significant quantities of alumina for export. Yugoslavia's main lead and zinc resources are mined, refined and smelted in Kosovo and Macedonia. In 1974, the share of basic industries in total industrial fixed assets in the LDRs was 61 percent, in industrial value added, 45 percent, and in industrial employment, 29 percent, compared to the respective shares of 52 percent, 28 percent and 17 percent in the DRs. Because of the dominance of basic industries in the four LDRs, the industrial pattern in these regions is more capital-intensive than in the DRs. The share of processing or fabricating industries like metal products and textiles, which are more labor-intensive, is substantially below the Yugoslav average.
Industrial Objectives and Policy

32. Industry will continue to be the prime mover of economic growth in Yugoslavia as a whole and in the four LDRs. The 1976-80 Federal Plan projects the industrial growth rate at 8 percent per annum, compared to the projected GNP growth rate of 7 percent, and allocates 56 percent of social sector fixed investment to industry. The 1976-80 Federal and Regional Plans designate energy and other basic industries as priority sectors. The share of basic industries in total industrial fixed investment in Yugoslavia will rise to 63 percent in this period. The share of basic industries in the LDRs is projected to be almost similar. The choice of the priority sectors was necessitated by the need to remove "structural imbalances" in the Yugoslav economy (also referred to in para 12 above). The dependence of the economy on imports of raw materials and equipment was considered excessive and certain domestic growth constraints, particularly in energy, agriculture and transportation, considered serious. The Yugoslav strategy, therefore, has tended to aim at a balanced development of the economy through encouraging the growth of those sectors and branches that have tended to lag behind in the period after the 1965 reforms and concomitantly to achieve a significant import substitution in priority sectors (mainly producing intermediate goods).

33. While the choice of the priority sectors is understandable, the impact of this strategy on employment generation would be limited. Since the average capital-labor ratio in priority sectors is more than twice as high as the industrial average, the plan resource allocation pattern implies a relatively high investment-per-job created and, by implication, limited additional employment opportunities. Recognizing the limited impact of the priority sectors on employment generation, the Plan strategy recognizes the need for emphasis on labor-intensive and small-scale industries. Social Compacts (defined in footnote 1, page 7, this Report) on small-scale industries, which specify promotional measures such as tax incentives and preferential credit facilities, have been adopted. Social Compacts on employment in the social sector have also been concluded within and between the regions. Communities of Interest (defined in para 5, this Report) for employment, consisting of representatives of job-seekers and employers, have been created to coordinate inter- and intra-republic employment policy. In addition, policies have been adopted to encourage private sector employment and include fiscal incentives and the creation of a new legal concept, the Contractual Organization of Associated Labor, which can be private or mixed private-social in terms of ownership and circumvents the five-employee limitation that has applied to privately owned businesses. This form of enterprise may facilitate absorption of returning migrants and the underemployed in the agricultural sector. The extent of effectiveness of the new employment policies is, however, still to be ascertained.

34. The problems of unemployment (noted in para 8, this Report) and inter-regional disparities in income (para 7) will persist in the near future. The rate of unemployment in Yugoslavia reached 11.9 percent in 1976, the rate in the LDRs being 17.6 percent and that in Kosovo 25.4 percent. The rapid migration from the agricultural sector, the limited inter-regional migration, and the return of migrant workers are important aspects of the employment
The problem in the LDRs is accentuated by the much faster natural increase in population (see para 4, this Report), particularly in Kosovo with an annual population growth of 2.9 percent during 1971-76. Consequently, even if the target growth rates of social sector employment in the LDRs during 1976-80 were realized, they would be barely sufficient to absorb the natural increase in the labor force and returning migrants and to reduce registered unemployment by 25 percent in Bosnia-Herzegovina, Macedonia and Montenegro; while in Kosovo it would be barely sufficient to absorb the natural increase and returning migrants. The need to lessen and overcome the problems of unemployment and interregional disparities is therefore seen by the Yugoslav authorities concerned as necessitating a policy of industrial development for the LDRs that, in addition to diversifying the industrial structure by encouraging investment in medium- and small-scale processing industries, gives a more vigorous emphasis to promoting labor-intensive projects.

In Kosovo, the poorest region of Yugoslavia, the need is particularly compelling to devote greater attention, through industrial credit activity, to developing both processing facilities as an adjunct to the schemes for natural resource exploitation and, given the Province's relative lack of trained manpower, appropriately designed projects which are responsive to Kosovo's need for ameliorating rural poverty and generating employment.

B. The Financial Sector

Multi-purpose banks are the dominant form of financial intermediaries, carrying out all commercial and investment banking functions for all sectors of the economy. Each region of Yugoslavia has such a major bank, though these banks can also have branches in other regions. The four proposed borrowers are in this category and handle some 80 percent of investment and commercial banking in their respective regions. In addition to these banks, the financial sector includes the National Banks, which essentially perform the role of central banks at the Federal and Regional levels, post office savings institutions, investment loan funds and insurance institutions.

The investment loan funds of the banks in the LDRs consist primarily of resources provided through the Federal Fund (see para 7, this Report) and similar funds within the regions. These funds derive their resources from obligatory loans levied on enterprise income and, according to agreed upon criteria for allocation to the various LDRs, transfer their resources to the respective multi-purpose banks.

A new Banking Law became effective on January 15, 1977. The main emphasis is on the reorganization of banks so that their services and functions are more closely integrated and directed to the financial needs of their founders (which are their depositors and borrowers). Accordingly, the new Law requires some changes in the organization and structure of the multi-purpose banks, but have little if any practical effect on their ability to carry on their operations.

Given the current planning mechanism (see para 16, this Report), interest rates in Yugoslavia are assigned a limited role in resource mobilization and allocation. This reflects the Marxist theoretical premise that
capital is not a separate factor of production but "past labor". The need for financial intermediation is accepted, however, along with interest rates. Each bank's founders establish the bank's borrowing and lending rates each year. As the banks are not profit oriented but service oriented, the spread is kept as low as possible (about 2 percent is the usual target to cover administrative expenses and mandatory provisions). The Yugoslav authorities plan to undertake a comprehensive study on the role of interest rates in Yugoslavia which is expected to be completed during the commitment period of the proposed loan. The study is to be executed in conjunction with the Second Agricultural Credit Project (Loan 1477 of July 29, 1977) and is expected to be completed by the end of this year.

40. Within the framework of the regional development plans and their own plans, the multi-purpose banks, including the borrower under the proposed loan, play a key role in allocating funds to sound projects. The demand on these banks for financing has consistently exceeded the supply of resources available to them, allowing them to be selective in deciding on projects they will support. They have the authority (which they exercise), working in cooperation with the regional Economic Chambers (which encompass associations of workers in the different economic sectors), to approve, modify or reject specific investment proposals.

41. The multi-purpose banks mobilize domestic resources by attracting deposits from households, enterprises and other organizations. Their foreign resource mobilization efforts are directed at guaranteeing suppliers' credits (the most important activity in terms of amounts involved), attracting deposits of Yugoslav workers abroad and obtaining foreign loans.

PART IV - THE PROJECT

42. The proposed project, which is summarized in the Loan and Project Summary at the beginning of this report and described in detail in the "Staff Appraisal Report on a Third and Fourth Industrial Credit Project" No. 1865a-YU dated June 23, 1978 was appraised by a mission which visited Yugoslavia in October 1977. Negotiations were held in Washington during March 7-14, 1978 inclusive. The Yugoslav delegation was led by Mr. Aleksander IlIic, Vice President, Federal Committee for Industry and Energy, and included representatives of KBP.

Background

43. The proposed Third Project, with the concurrently proposed Fourth Industrial Credit Project, is a sequel to the First and Second Industrial Credit Projects (Loans Nos. 1012/1013 and 1277 of June 21, 1974 and June 14, 1976, respectively). These previous two loans had the dual objectives of (a) financing small- and medium-size sub-projects in manufacturing and processing industries, and (b) institution-building. Progress in achieving these objectives is considered to be on the whole satisfactory. Three of the four participating banks, Investiciona Banka Titograd (IBT), Stopanska Banka
Skopje (SBS) and Privredna Banka Sarajevo (PBS), have committed their portions of the earlier loans at a satisfactory rate. Commitments by Kosovska Banka Pristina (KBP), the proposed borrower for this loan, have been considerably slower, reflecting particular problems in Kosovo (see paras 57 and 58, this Report). The first industrial credit line has been fully committed. While under the second line of credit KBP has only committed about US$5.6 million equivalent of its US$16.6 million portion, it has in hand appraised sub-projects which are being translated and will be submitted to the Bank by end-June 1978 and which would totally utilize the balance. Hence, by end-July, 1978, the second credit line should also be fully committed.

44. The financial rate of return (FRR) estimated by the four participating banks for sub-projects above the free limit (see para 60, this Report) financed under the first and second credit lines ranged from 15 percent to over 45 percent, while the estimated economic rate of return (ERR) ranged from 12 percent to above 40 percent; the agreed minimum being 10 percent under the First and 11 percent under the Second Industrial Credit Projects. The estimated average total cost per job created by these projects was US$39,400 equivalent in 1977 prices, which is a satisfactory average in view of the relatively advanced stage of economic development of Yugoslavia. The second project was also aimed at encouraging foreign co-financing by providing a higher limit for a sub-project's total cost and a longer grace period for such co-financed sub-projects, and the results to date are reassuring. Twelve PBS sub-projects have attracted co-financing almost matching the amount provided to these sub-projects by the Bank, and six SBS sub-projects have attracted co-financing equivalent to about two-thirds of the amount of the Bank loan committed to these sub-projects. In the case of IBT, two sub-projects have received co-financing almost equal to the Bank's commitment of US$2.6 million equivalent. So far, one of KBP's sub-projects has received co-financing slightly exceeding the Bank's commitment of US$2.5 million equivalent. Such co-financing has been primarily in the form of medium-term commercial credits. Institution building under the first two projects has progressed satisfactorily. The quality of appraisal work has improved and techniques, such as those used for financial and economic rates of return calculations, are now widely employed in most project appraisals, whether Bank-financed or not. The first industrial credit line is expected to be fully disbursed by the end of 1978, at which time a project completion report (PCR) will be prepared. Data are expected to be furnished to the Bank for this purpose as well as for the preparation of a PCR on the Second Project. The Borrower, in conjunction with the three banks under the proposed Fourth Project (Fourth Industrial Credit Loan Agreements, Section 3.04(b)) has undertaken to prepare PCRs on the proposed Third and Fourth Industrial Credit Projects during the first quarter of 1984 (Third Industrial Credit Loan Agreement, Section 3.04(b)).

Objectives of the Proposed Loan

45. The objectives of the proposed loan under the proposed Third Industrial Credit Project encompass those of the previous two projects which, in addition to providing foreign exchange resources to finance industrial development, were to contribute to the economic development of the LDRs, including
Kosovo, and create employment opportunities and assist in further strengthening the borrowing institutions. The proposed project, in addition to these objectives, attempts to address more directly the problem of unemployment in Kosovo. A portion of the proposed loan will be designated specifically for labor-intensive sub-projects, defined as sub-projects providing employment at a maximum cost per job of US$23,000 equivalent. This figure was arrived at utilizing the same methodology applied within the Bank for devising thresholds of urban poverty in member countries and takes into account 1979 prices which will prevail at the time the proposed project is actually to be implemented. It should be noted that this (along with the proposed Fourth Project) is the first project in Yugoslavia to have a specific labor-intensive component and thus should serve to heighten awareness of the need to, and desirability of, providing jobs at as low a cost as possible.

The Borrowing Bank

46. The borrowing bank under the proposed third project is Kosovska Banka Pristina (KBP), one of the four banks (all multi-purpose) that participated in the first and second projects. The basic legal framework for these multi-purpose banks is the new Banking Law (see para 38, this Report). Like the other multi-purpose banks, KBP has its own self-management agreement and statutes; its operations from the viewpoint of overall credit and monetary policy as well as its liquidity position are regulated by the National Bank and supervised by the Social Accounting Service (SDK). Members of KBP, who constitute its General Assembly, include organizations of associated labor (from most of the enterprises in Kosovo served by KBP) and other social sector organizations with the exception of governments. Every member has one vote in the Assembly, the highest governing body of the bank. The Assembly approves the medium-range plan, annual plan and business policy (including interest rates), and these plans are harmonized with the plans of bank member organizations as well as with the Provincial Plan and the National Plan.

47. The Assembly appoints, for a four-year term, a General Manager who is the chief executive. Appointments are made on the basis of professional competence and changes are infrequent. The quality of senior management is generally good. The number of KBP employees is about 600. The bank is functionally divided into departments at the head office level and has eleven branches.

48. Policies and Procedures. KBP does not have formal financial policies per se concerning its operations such as exposure limits and maximum debt to equity ratio. Nevertheless, it generally follows prudent practices. The members of the bank agree on the distribution of loans among themselves and any substantial allocation of funds to a particular project would have to be in accordance with the plan (approved by the Assembly—see para 46, above). KBP has qualified project appraisal and supervision staff, though some staff shortages exist. While appraisal reports received from the bank are generally good, further upgrading is desirable. The use of financial and economic rates
of return is becoming more widespread and is being applied to other than Bank projects. Supervision work is satisfactory, as are disbursement and procurement procedures.

49. **Financial Position.** KBP plans its operations on a disbursement basis rather than on a commitment basis. As a result, it has substantial overcommitments vis-à-vis available resources at any point in time which will be covered by transfers from the Federal Fund and other sources. Its balance sheet indicates a satisfactory liquidity position; its debt/equity ratio, although seemingly high, is not to be conventionally interpreted since, in the Yugoslav context, capital contributions are minimized, almost all being for liquidity and operational funds. Most of the bank resources forming liabilities come from the deposits of enterprises, household savings deposits and from Federal and Regional Funds, the latter having the character of managed funds with KBP acting essentially as a conduit for disbursing them in accordance with the provisions of the regional plan and agreements undertaken by Kosovo. In any case, the solvency of KBP, as for similar banks elsewhere, is a function of the solvency of its members (each member assuming unlimited liability for the bank's debts) and, ultimately, the economy as a whole. The fact that the bank is not profit-oriented is reflected in its income statements. KBP does, however, earn somewhat more than is necessary to break even, the excess being either retained or returned to its founders.

50. **KBP's arrears position has improved over the two years from June 1975 to June 1977,** reflecting the improved liquidity position of enterprises and the intensified collection procedures followed by the bank. It has not experienced significant write-offs in the past and reschedulings have been few. However, because of the limited availability of data and the multipurpose nature of the bank, it is difficult to assess the quality of its long-term loan portfolio. In the framework of annual audits to be undertaken by the Borrower (Loan Agreement, Section 4.02), KBP has assured the Bank that it will carry out an annual portfolio analysis covering loan arrears and reschedulings and, on the basis of this analysis, assess the risk and magnitude of possible losses. This understanding is similar to the one reached in connection with the Second Agricultural Credit Project (Loan 1477-YU of July 29, 1977) and is identically reflected in the terms of the proposed loans under the simultaneously proposed Fourth Industrial Credit Project.

51. **KBP is now audited by the Social Accounting Service (SDK) following,** to the extent possible, generally accepted international accounting standards. While normal audits per Yugoslav standards are currently carried out for KBP, it is expected that SDK will be able to execute audits on the bank in accordance with acceptable international standards on the 1977 and future accounts. This steady progress in extending audits is one tangible result of a Bank supported training program for SDK which began in 1974.

52. **KBP is considered creditworthy for Bank lending,** though a conventional assessment of creditworthiness is neither fully possible nor entirely appropriate in view of the unique Yugoslav economic system. This assessment is based on the fact that (a) there have been no significant loan losses in the past and the arrears situation is manageable; (b) management of resources
and appraisal and supervision of projects are sound; and (c) KBP is such an
integral part of its region's economy and the economy as a whole that failure
is exceedingly unlikely.

53. Operations. The main areas of operation of KBP are loans and
guarantees; equity investments are negligible. Long-term loan commitments
have increased over the past several years, reflecting the increase in invest-
ment activities in Kosovo. In 1976, loan commitments of KBP totalled $290.1
million equivalent, of which loans for industrial projects accounted for
two-thirds. Guarantees in favor of enterprises also have shown an increasing
trend, totalling $220.8 million equivalent in 1976.

54. Forecast of Operations. KBP's five-year forecast of operations
indicates that it expects long-term loan commitments to continue to expand.
Its long-term resource mobilization plans appear reasonable, with Federal
Funds expected to be the largest source. The projected financial statements
reflect the bank's efforts to maintain a spread only sufficient to cover costs
and mandatory provisions. The liquidity position, however, is forecast to be
satisfactory.

Features of the Proposed Loan

55. Labor-Intensive Sub-Projects. In accordance with the proposed proj-
ect's specific focus on dealing with unemployment in Kosovo, 12.5 percent
(US$5.0 million equivalent) of the funds under the proposed project would be
earmarked for labor-intensive sub-projects, defined in para 45 above. As the
main purpose of these sub-projects is to provide low-cost jobs, there would be
no limitations on the size of sub-projects or of sub-loans, or on the type of
sub-projects as there would be for "normal" projects (see para 56), provided
they satisfy the usual technical, financial and economic criteria.

56. Diversification. About 37 percent of the KBP Loan (US$14.7 million
equivalent) would continue to be used for financing "normal" small- and medium-
size sub-projects in manufacturing and processing, the same types as were
financed under the previous industrial credit lines, with limitations as set
out in para 59. This is aimed to promote diversification within the indus-
trial sector of Kosovo which tends to be heavily biased in favor of large,
capital-intensive basic industries.

57. "Special" Projects. One of the characteristics of projects in Kosovo
is that they tend to be large. This reflects the past pattern of industrial
development in the Province where the primary focus has been on exploiting
large mineral deposits and on the processing and utilization of such minerals;
this type of industry tends to consist of large enterprises. As a result, KBP
has experienced difficulty under the first two industrial credit projects in
identifying suitable sub-projects that did not exceed the normal maximum size
limitations imposed in the loan agreements, and this has led to delays in
committing the preceding loans. To help avoid a repetition of this situation
and in response to Government's request, a part of KBP's proposed loan (50
percent or US$20.0 million equivalent) would be allocated in advance for three
"special" projects already tentatively identified. These "projects" are larger
than the normal limits would ordinarily permit but otherwise meet all of the usual criteria. It should be noted that while these three "projects" are likely to be the largest financed under the proposed loan, they are still smaller than typical projects that attract direct Bank lending. The first is the modernization and expansion of a lead smelter and refining plant. Without the project, the plant would have to close and over 1,000 jobs would be lost. The second is the establishment of a heavy duty battery plant which is expected to export some 70 percent of its production. The third is a plant to produce casing and plastic parts for the heavy duty battery plant. All three are being prepared by the Trepca Kombinat and are expected to involve foreign co-financing. The "projects" will include the installation of suitable anti-pollution devices, especially needed at the lead smelter (at present there is a high incidence of lead poisoning in the plant area). These "projects" will use local raw material, will be located in underdeveloped communes in Kosovo and will help to diversify the industrial sector. Each will be reviewed by the Bank in a more intensive fashion than normal, including field missions. Procurement procedures must meet the requirements discussed in para 64 of this Report. If one or more of these "projects" proves to be unacceptable, it could be replaced by others provided the substitute "projects" create or retain jobs at a cost per job of no more than US$60,000 equivalent (Loan Agreement, Section 2.02(d)).

58. In further recognition of the special difficulties faced in Kosovo by enterprises and by KBP in identifying, preparing and then operating projects in new fields (for example, diversifying from basic industries to processing industries), a portion of KBP's proposed loan, as noted in para 66 below, would be allocated to technical assistance. KBP has indicated four areas where it and its clients could use such assistance: the first concerns marketing advice regarding individual sub-sectors (such as textiles or wood products) to help identify promising new project concepts; the second involves assistance by foreign specialists in reviewing large projects prepared by enterprises; the third relates to technical advice for projects already in production but which are experiencing operational difficulties; and the fourth concerns training abroad (in appropriate industries rather than in academic institutions) for KBP staff or for the staff of a project already in operation.

59. Sub-project and Sub-Loan Size. Under the Second Industrial Credit Project, the total cost of sub-projects was limited to US$6.0 million equivalent unless there was foreign-co-financing involved when a higher limit of US$10.0 million equivalent applied. These limits on total sub-project cost were imposed to help ensure that small- and medium-size sub-projects were financed as they tend to be more labor-intensive than large sub-projects. To allow, however, for the possibility that a larger sub-project may also be relatively labor-intensive, it is now proposed to consider for financing under the proposed project, sub-projects whose total cost exceeds US$10.0 million equivalent if they create jobs at a total cost per job of US$40,000 equivalent or less. This figure is two-thirds of the average fixed investment cost per new job in the industrial sector in the LDRs in 1979 prices, based on the average for 1974-75 (US$60,500 equivalent). It is less than the average cost per
job created by sub-projects above the free limit under the previous two projects, again adjusted for past and expected inflation (US$45,750 equivalent). For that portion of the proposed loan allocated to "normal" sub-projects, sub-loans would normally not exceed US$3.0 million equivalent (the limit under the Second Industrial Credit Project was US$2.5 million equivalent), ensuring the financing of a reasonably large number of sub-projects (Loan Agreement, Schedule 4, C, 6(b) and (c)).

60. Free Limit. In recognition of the improvements in KBP's project appraisal work and because of the Bank's growing familiarity with and greater confidence in this institution, the free limit on individual sub-loans (including sub-loans to labor intensive sub-projects) would be raised from the $300,000 established under the second industrial credit line to US$1.0 million. The aggregate free limit would also be raised from about 40 percent to 60 percent of that portion of KBP's loan allocated to "normal" and labor intensive sub-projects (Loan Agreement, Section 2.02(b)). This will allow the Bank to review for approval about three or four sub-projects, a reasonable number, plus the three "special" projects referred to in para 57 above.

61. Terms of Sub-loans. Individual sub-loans would be repaid over a period not exceeding 15 years from the date of signing of the proposed loan (Loan Agreement, Section 2.08). Grace periods would normally be up to three years, with up to five years allowed when there is co-financing and the need for such a longer grace period is demonstrated (para 63 below).

62. As under the Second Industrial Credit Project (and as noted in para 44, this Report), sub-projects would have to have a minimum FRR and ERR of 11 percent. The on-lending rate to be charged by KBP on Bank funds would be 11 percent with the sub-borrowers assuming the foreign exchange risk (Loan Agreement, Schedule 4, para C 6(f)). This rate approximates current market costs of foreign borrowings to Yugoslav investors and is also the same as applied under the Second Industrial Credit Project. In addition, unless the Bank should otherwise agree, domestic resources lent to social sector sub-projects receiving Bank funds will carry an interest rate of at least 6 percent and to private sector sub-projects, at least 5 percent (Loan Agreements, Section 3.07). This is the same condition introduced under the Second Agricultural Credit Project (Loan No. 1477), approved in July 1977, and is a further step toward unifying lending rates on local funds country-wide by introducing floor interest rates into the industrial sector.

63. As under the Second Industrial Credit Project, co-financing will continue to be encouraged in conjunction with the proposed project by allowing longer grace periods (up to 5 years) on sub-loans when the sub-project is also being financed from other foreign sources (Loan Agreement, Schedule 4, para C 6(f)). These other sources typically require repayment in five to six years with a grace period of only one to two years; therefore a longer grace period on Bank sub-loans will provide a more appropriate cash flow pattern for the project by blending Bank funds with medium-term credits. The proposed loan would be repaid according to amortization schedules based on the composite of individual amortization schedules for sub-loans. These arrangements are substantially the same as for the Second Industrial Credit Project.
64. Procurement. Some sub-projects may be received that are of such a size and nature that international competitive bidding (ICB), using the Bank's Guidelines for Procurement, might be the most economical and efficient method of procurement. While the detailed criteria identifying such sub-projects cannot be established in advance, the total cost of an individual contract is a reasonable proxy. Under the proposed project, therefore, while the appropriateness of ICB should be considered for all foreign procurement, any individual contract for imported goods that is expected to exceed US$2.0 million equivalent will be a candidate for procurement under ICB. If KBP and its sub-borrower decide that ICB is not appropriate, this decision must be justified to the Bank before the sub-project will be considered as eligible for Bank financing; if they do follow ICB, and a Yugoslav supplier wins the bid, the ex-factory cost of these goods would be eligible for financing with Bank funds, a situation expected to arise only in rare instances. The Bank will undertake a full review of all procurement documents and procedures for contracts expected to exceed US$4.0 million equivalent that are procured under ICB and will selectively review smaller contracts (Loan Agreement, Section 2.03 and Schedule 4, C.6.(g)).

65. Joint Unit and Sub-Units. A joint Unit, consisting of four Sub-Units, one each from KBP and PBS, SBS and IBT (the latter three participating under the parallel proposed Fourth Industrial Credit Project), will handle administrative matters involving all four banks. KBP's Sub-Unit will handle those matters, including sub-loan requests, which affect it.

66. Institution Building. Assistance in institution building will be provided through review of KBP's appraisal reports on the larger projects submitted (including the "special" projects) as well as through periodic visits and consultations. As stated in para 58 above, in view of KBP's particularly acute needs in this area, a portion of the proposed loan would be specifically allocated to technical assistance.

Justification and Risk

67. The proposed loan is justifiable at the macro level on the grounds that it will lead to the creation of highly needed job opportunities in Kosovo while contributing to the overall development and improvement of the standard of living of this, the poorest region of Yugoslavia. Based on the projects identified by KBP at the time of appraisal as being eligible for financing under the proposed loan, some 3,000 jobs would be created or retained. The new emphasis on maximizing the number of jobs created per dollar invested is expected to result in approximately 200 of these jobs being created or retained at a cost of less than $23,000 equivalent each, the urban poverty program threshold as adjusted to forecast 1979 costs (see para 45, this Report). The proceeds of the proposed loan will not be used to finance projects in basic industry, which are relatively capital intensive, but instead will promote diversification of the industrial sector of Kosovo towards processing and better integration into the overall Yugoslav industrial structure.
68. At the micro level, the ERR of sub-projects to be financed from the proposed loan is not known at this time, as is usual for DFC projects. However, the estimated ERR of sub-projects financed under the past two industrial credit projects has ranged from 12 to above 40 percent, on average well above the minimum acceptable rate of 11 percent established in the second loan agreement (10 percent in the first). Sub-projects financed under the proposed loan are expected to yield similar results. One-third of the sub-projects identified by KBP would involve foreign co-financing to cover part of the foreign exchange costs.

69. There are no special risks associated with the proposed loans.

PART V - LEGAL INSTRUMENTS AND AUTHORITY

70. The draft Loan Agreement between the Bank and Kosovska Banka Pristina, the draft Guarantee Agreement between the Socialist Federal Republic of Yugoslavia and the Bank and the report of the Committee provided for in Article III, Section 4 (iii) of the Articles of Agreement are being distributed to the Executive Directors separately.

71. Special features of the loan are discussed in paragraphs 44, 55, 57, 58, 59, 62, 63, 64 and 65.

72. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank.

PART VI - RECOMMENDATIONS

73. I recommend that the Executive Directors approve the proposed loan.

Robert S. McNamara
President

Attachment
June 26, 1978
Washington, D.C.
### DISTRIBUTION OF LAND OWNERSHIP

<table>
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<th>Percentage</th>
<th>Yugoslavia</th>
<th>Reference Countries (1970)</th>
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<td>Top 10%</td>
<td>18.7%</td>
<td>15.0% /b 15.1% /b 15.6% /a</td>
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<tr>
<td>Smallest 10%</td>
<td>71.7%</td>
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### CONSUMPTION

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<td>Radio Receivers (per 1000 pop)</td>
<td>85.0</td>
<td>161.0 193.0 152.0 214.0 318.0</td>
</tr>
<tr>
<td>Pneumatic Cars (per 1000 pop)</td>
<td>3.0</td>
<td>25.0 72.0 24.0 71.0 226.0</td>
</tr>
<tr>
<td>Electricity (kWh/yr per Cap)</td>
<td>480.0</td>
<td>1288.0 1867.0 1615.0 1634.0 4128.0</td>
</tr>
<tr>
<td>Newspapers (kg/yr per Cap)</td>
<td>2.3</td>
<td>4.3 3.8 2.6 5.8 17.7</td>
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</tbody>
</table>
### ECONOMIC DEVELOPMENT DATA

#### (Amounts in Million US Dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual</th>
<th>Preliminary</th>
<th>Estimated</th>
<th>Average Annual Growth Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Domestic Product</td>
<td>21,438</td>
<td>22,727</td>
<td>26,765</td>
<td>25,887</td>
</tr>
<tr>
<td>Gross Domestic Income</td>
<td>25,106</td>
<td>25,401</td>
<td>26,765</td>
<td>26,059</td>
</tr>
<tr>
<td>Gains from Terms of Trade</td>
<td>466</td>
<td>580</td>
<td>831</td>
<td>850</td>
</tr>
<tr>
<td>Resource Gap</td>
<td>1,131</td>
<td>1,182</td>
<td>1,618</td>
<td>2,072</td>
</tr>
</tbody>
</table>

#### NATIONAL ACCOUNTS

**Constant 1974 Prices and Exchange Rate of $1 = 17.0 Din.**

- **Gross Domestic Product**
- **Gains from Terms of Trade**
- **Resource Gap**

**Average Annual Growth Rates As Percent of GDP**

- **Gross Domestic Product**: 5.6%
- **Gains from Terms of Trade**: 12.6%
- **Resource Gap**: 8.3%

#### GROSS DOMESTIC INCOME

- **Gross Domestic Income**: 22,106
- **Gross Domestic Income**: 23,401
- **Gross Domestic Income**: 24,765
- **Gross Domestic Income**: 26,029
- **Gross Domestic Income**: 27,119

#### IMPORTS (incl. NFS)

- **Imports (incl. NFS)**
- **Exports (incl. NFS)**

#### MERCHANDISE TRADE

**Annual Data at Current Prices As a Percentage of Total**

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<tbody>
<tr>
<td><strong>Imports</strong></td>
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<td>Capital Goods</td>
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<td>Petroleum and Fuels</td>
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<td>Non-ferrous Metallurgy</td>
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<td>Agricultural Products</td>
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<td>Other</td>
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<tr>
<td><strong>Exports</strong></td>
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<td>Capital Goods</td>
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<td>Textile and Leather Goods</td>
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<tr>
<td>Non-ferrous Metallurgy</td>
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<tr>
<td>Agricultural Products</td>
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<tr>
<td>Other</td>
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#### MERCHANDISE TRADE INDICES

**1974-100**

- **Export Price Index**: 63
- **Import Price Index**: 58
- **Terms of Trade Index**: 109
- **Export Volume Index**: 93

#### VALUE ADDED BY SECTOR

**Annual Data in Constant 1974 Prices and Exchange Rate of $1 = 17.0 Din.**

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<tr>
<td><strong>Agriculture</strong></td>
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<tr>
<td><strong>Manufacturing and Mining</strong></td>
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<tr>
<td><strong>Other</strong></td>
<td></td>
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<tr>
<td><strong>Total</strong></td>
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#### PUBLIC FINANCE

**Current Prices**

- **Current Receipts**: 2,772
- **Current Expenditures**: 2,520
- **Budgetary Savings**: 251
- **Public Sector Investment**: 226

#### LABOR FORCE AND OUTPUT PER WORKER

**Total Labor Force**

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<thead>
<tr>
<th>Year</th>
<th>1972</th>
<th>1973</th>
<th>1974</th>
<th>1975</th>
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<tr>
<td><strong>Labor Force in Million</strong></td>
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<tr>
<td><strong>Labor Force in Billion</strong></td>
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Europe, Middle East and North Africa Region
January 27, 1978
### BALANCE OF PAYMENTS AND EXTERNAL ASSISTANCE AND DEBT

#### SUMMARY OF BALANCE OF PAYMENTS

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<tbody>
<tr>
<td>Exports (incl. NFS)</td>
<td>3424</td>
<td>4363</td>
<td>5696</td>
<td>6307</td>
<td>7259</td>
<td>7985</td>
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<td>Imports (incl. NFS)</td>
<td>3828</td>
<td>5124</td>
<td>8337</td>
<td>8760</td>
<td>8664</td>
<td>10232</td>
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<tr>
<td>Resource Balance (X-M)</td>
<td>-406</td>
<td>-761</td>
<td>-2641</td>
<td>-2453</td>
<td>-1405</td>
<td>-2847</td>
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<tr>
<td>Interest</td>
<td>-165</td>
<td>-222</td>
<td>-285</td>
<td>-337</td>
<td>-350</td>
<td>-428</td>
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<td>Workers Remittances</td>
<td>889</td>
<td>1301</td>
<td>1511</td>
<td>1575</td>
<td>1728</td>
<td>1750</td>
<td>18.1</td>
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<td>Other factor services net</td>
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<td>50</td>
<td>93</td>
<td>62</td>
<td>40</td>
<td>42</td>
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<td>Current Transfers (net)</td>
<td>82</td>
<td>96</td>
<td>138</td>
<td>121</td>
<td>137</td>
<td>150</td>
<td>13.6</td>
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<tr>
<td>Balance on Current Account</td>
<td>419</td>
<td>464</td>
<td>-1164</td>
<td>-1032</td>
<td>150</td>
<td>-1333</td>
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<td>M&amp;LT Loans /1</td>
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<tr>
<td>Disbursements</td>
<td>943</td>
<td>1170</td>
<td>1426</td>
<td>1850</td>
<td>1700</td>
<td>2424</td>
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<tr>
<td>Repayments</td>
<td>-570</td>
<td>-686</td>
<td>-814</td>
<td>-930</td>
<td>-800</td>
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<tr>
<td>Net Disbursements</td>
<td>373</td>
<td>484</td>
<td>612</td>
<td>920</td>
<td>900</td>
<td>1333</td>
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<td>Capital Transactions n.e.i. /2</td>
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<td>-235</td>
<td>139</td>
<td>-68</td>
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<td>Actual</td>
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<td>Use of Reserves</td>
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<td>-663</td>
<td>438</td>
<td>180</td>
<td>-917</td>
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<tr>
<td>Total Public M&amp;LT Loans</td>
<td>466.8</td>
<td>287.6</td>
<td>997.2</td>
<td>569.9</td>
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<tr>
<td>Official Grants &amp; Grant-like</td>
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#### GRANT AND LOAN COMMITMENTS

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<tr>
<td>Public M&amp;LT Loans</td>
<td>75.0</td>
<td>104.9</td>
<td>256.5</td>
<td>209.0</td>
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<tr>
<td>IBRD</td>
<td></td>
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<tr>
<td>IDA</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<tr>
<td>Other Multilateral</td>
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<td>-</td>
<td>-</td>
<td>-</td>
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<td>Governments</td>
<td>183.9</td>
<td>179.7</td>
<td>615.4</td>
<td>274.7</td>
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<td>Suppliers</td>
<td>82.3</td>
<td>3.0</td>
<td>-256</td>
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<td>Financial Institutions</td>
<td>121.4</td>
<td>-</td>
<td>73.1</td>
<td>86.2</td>
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<tr>
<td>Bonds</td>
<td>-</td>
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<td>Public Loans n.e.i.</td>
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<tr>
<td>Total Public M&amp;LT Loans</td>
<td>559.1</td>
<td>287.6</td>
<td>997.2</td>
<td>569.9</td>
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<td>Public Debt Out. &amp; Disbursed</td>
<td>1618.0</td>
<td>1869.3</td>
<td>2056.3</td>
<td>2272.5</td>
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#### DEBT AND DEBT SERVICE /4

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<td>World Bank</td>
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<td>Disbursements only</td>
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<td>Percent</td>
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<tr>
<td>Average Terms of Public Debt</td>
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<td>Int. as % Prior Year</td>
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<tr>
<td>DO&amp;D</td>
<td>4.7</td>
<td>6.0</td>
<td>5.4</td>
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<td>Amort. as % Prior Year</td>
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<td>DO&amp;D</td>
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<td>13.1</td>
<td>15.0</td>
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<tr>
<td>1/ Includes direct foreign investment.</td>
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<tr>
<td>2/ Includes errors and omissions, short term loans, net export credits, IMF account, National Bank and Commercial Bank Credits.</td>
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<tr>
<td>3/ Estimate.</td>
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<td>4/ Figures on debt service do not correspond with balance of payments figures due to differences in coverage.</td>
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<tr>
<td>5/ Includes workers remittances.</td>
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### A. STATEMENT OF BANK LOANS (as at April 30, 1978)

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<th>Number</th>
<th>Year</th>
<th>Borrower(s)</th>
<th>Purpose</th>
<th>US$ million</th>
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<tr>
<td></td>
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<td></td>
<td>Amount (less cancellations)</td>
<td>Bank</td>
</tr>
<tr>
<td>Twenty-one Loans fully disbursed</td>
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<td>567.7</td>
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<td>777</td>
<td>1971</td>
<td>SFRY</td>
<td>Multipurpose Water</td>
<td>45.0</td>
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<td>782</td>
<td>1971</td>
<td>&quot;Babin Kuk&quot; Hotelsko Turisticki Centar, Dubrovnik</td>
<td>Tourism</td>
<td>20.0</td>
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<td>836</td>
<td>1972</td>
<td>Twelve Electric Power Enterprises in Yugoslavia</td>
<td>Power</td>
<td>75.0</td>
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<td>894</td>
<td>1973</td>
<td>Stopanska Banka, Skopje</td>
<td>Agricultural Industries</td>
<td>31.0</td>
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<td>916</td>
<td>1973</td>
<td>Naftagas</td>
<td>Gas Pipeline</td>
<td>59.4</td>
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<td>990</td>
<td>1974</td>
<td>Bosnia-Herzegovina Road Funds</td>
<td>Roads</td>
<td>30.0</td>
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<td>1012</td>
<td>1974</td>
<td>Stopanska Banka, Skopje</td>
<td>Industrial Credit</td>
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<td>1013</td>
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<td>Privredna Banka Sarajevo</td>
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<td>1026</td>
<td>1974</td>
<td>Community of Yugoslav Railways</td>
<td>Railways</td>
<td>93.0</td>
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<td>1060</td>
<td>1974</td>
<td>Port of Bar</td>
<td>Harbor Expansion</td>
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<td>1066</td>
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<td>Vodovod Dubrovnik</td>
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<td>Republic Road Organizations in Slovenia, Montenegro and Serbia</td>
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<td>Jugoslavenski Naftovod</td>
<td>Pipeline</td>
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<td>1262</td>
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<td>1277</td>
<td>1976</td>
<td>Privredna Banka Sarajevo, Stopanska Banka Skopje, Investicione Banka Titograd, Kosovska Banka Pristina</td>
<td>Second Industrial Credit</td>
<td>50.0</td>
</tr>
<tr>
<td>Number</td>
<td>Year</td>
<td>Borrower(s)</td>
<td>Purpose</td>
<td>Amount (less cancellations)</td>
</tr>
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<td>------</td>
<td>------------------------------------------------------------------------------</td>
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<td>Investiciona Banka, Titograd</td>
<td>Agriculture Industries</td>
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<td>1371</td>
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<td>Agriculture Industries</td>
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<td>1977</td>
<td>Republic Road Organizations in Bosnia-Herzegovina, Serbia, Macedonia, and Kosovo</td>
<td>Roads</td>
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<td>1977</td>
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<td>Second Power Transmission</td>
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<tr>
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<td>1977</td>
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<td>Second Agricultural Credit</td>
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<td>1978</td>
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<td>Roads</td>
<td>80.0</td>
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<td>of which has been repaid</td>
<td></td>
<td>195.5</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Total now outstanding</td>
<td></td>
<td>1,612.1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Amount sold</td>
<td></td>
<td>7.8</td>
</tr>
<tr>
<td></td>
<td></td>
<td>of which: Amount repaid</td>
<td></td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Total now held by Bank</td>
<td></td>
<td>1,611.1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Total undisbursed</td>
<td></td>
<td>813.3</td>
</tr>
</tbody>
</table>

/a Not yet effective.

/b A loan of US$73.0 million to Elektroprivredna Bosne i Hercegovine for a Middle Neretva Hydro Power Project was approved and signed subsequent to the above date of Statement A; it is not yet effective.
### B. STATEMENT OF IFC INVESTMENTS (as at April 30, 1978)

<table>
<thead>
<tr>
<th>Year</th>
<th>Obligor</th>
<th>Type of Business</th>
<th>Amount in US$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Loan</td>
</tr>
<tr>
<td>1970</td>
<td>International Investment Corporation for Yugoslavia</td>
<td>Investment</td>
<td>-</td>
</tr>
<tr>
<td>1970</td>
<td>Zavodi Crvena Zastava Fiat S.P.A.</td>
<td>Automotive</td>
<td>5.0</td>
</tr>
<tr>
<td>1971</td>
<td>Tovarna Automobilov in Motorjev, Maribor (TAM)/Klockner-Humboldt Deutz A.G. (KHD)</td>
<td>Automotive</td>
<td>7.5</td>
</tr>
<tr>
<td>1972</td>
<td>FAP-FAMOS Belgrade/Daimler Benz A.G.</td>
<td>Automotive</td>
<td>13.4</td>
</tr>
<tr>
<td>1972</td>
<td>Sava/Semperit</td>
<td>Tires</td>
<td>4.0</td>
</tr>
<tr>
<td>1973</td>
<td>Belisce/Bel</td>
<td>Pulp and Paper</td>
<td>13.3</td>
</tr>
<tr>
<td>1974</td>
<td>Zelezarnja Jesenice/ARMCO</td>
<td>Special Steel</td>
<td>10.0</td>
</tr>
<tr>
<td>1974</td>
<td>Salonit Anhovo</td>
<td>Cement Plant</td>
<td>10.0</td>
</tr>
<tr>
<td>1975</td>
<td>Rudarsko Metalurski</td>
<td>Steel</td>
<td>50.0</td>
</tr>
<tr>
<td>1977</td>
<td>Frikom ro Industrija Smrznute Hrane</td>
<td>Food and Food Processing</td>
<td>4.0</td>
</tr>
<tr>
<td>1977</td>
<td>Tvornica Kartona i Ambalaze Cazin</td>
<td>Pulp and Paper Products</td>
<td>15.4</td>
</tr>
</tbody>
</table>

Total Gross Commitments

less cancellations, terminations, exchange adjustment, repayment and sales

Total commitments held by IFC

Total Undisbursed
C. PROJECTS IN EXECUTION 1/

Loan 777 Ibar Multipurpose Water: US$45.0 million Loan of June 30, 1971; Effective Date: May 31, 1972; Closing Date: December 31, 1978.

The start of project work was delayed for one year. Construction is now underway, the main dam is completed and the reservoir is now being filled. A small part of the irrigation network has been completed with the remainder expected to be completed by 1979. Project costs have been above appraisal estimates, but the overrun financing is being provided by the Province of Kosovo and from Federal sources. Delays have been encountered in the arrangements for boundary adjustment. Consultants have been engaged to help find solutions, and the Kosovo Government has enacted appropriate legislation. After a delay of about five years, a draft law has been prepared by the Kosovo Government and is expected to be enacted in the near future, which will assist in the provision of agricultural extension services to the private sector.

Loan 782 Babin Kuk Tourism: US$20.0 million Loan of July 21, 1971; Effective Date: June 12, 1972; Closing Date: December 29, 1978.

There were initial delays in the implementation of the project due to lateness in making the loan effective and in mobilizing consultants. Bids for civil works and estimates for other components indicated that the project would cost at least twice as much as originally estimated (US$49.9 million), largely due to rapid inflation in construction costs. The Bank and the project sponsors agreed to finance a reduced complex containing some 2,034 beds (Amendment to Loan 782-YU, December 16, 1974, R74-259) at a total cost of US$51.5 million, requiring additional financing of about US$1.6 million and a change in sponsorship which has been approved by the Bank (Amendment to Loan 782-YU, October 4, 1976, R76-237). The hotels were inaugurated and opened for occupancy in June 1976. Occupancy rate for 1977 was below expectations notwithstanding 100 percent occupancy during high season. This gave rise to financial liquidity problems which were overcome with the assistance of the sponsoring Yugoslav banks. Advance bookings for 1978 represent a considerable improvement over the corresponding 1977 period.

1/ These notes are designed to inform the Executive Directors regarding the progress of projects in execution, and in particular to report any problems which are being encountered, and the action being taken to remedy them. They should be read in this sense, and with the understanding that they do not purport to present a balanced evaluation of strengths and weaknesses in project execution.
Loan 836 Power Transmission: US$75.0 million Loan of June 23, 1972; Effective Date: December 29, 1972; Closing Date: December 31, 1978.

The Project construction has progressed slowly and is expected to be completed by mid-1978, about one and one-half years late. Its cost has increased to about $415 million (up 84 percent) chiefly due to escalation in prices. The resulting cost overrun is being financed from funds received from the Federal Republic of Germany, local loans and from the Borrowers' own internal sources. Appointment of management consultants was delayed until mid-1976, but their recommendations have now been made and are being discussed with JUGEL and the Borrowers with the objective of beginning implementation of the recommendations by mid-1978. The promulgation of the new Constitution in 1974 and the consequent evolution of the legal and financial status of the Borrowers, particularly in regard to the requirement of their policy of pooling resources at the Republican levels required changes in the legal arrangements including the application of financial covenants. These changes were incorporated in the Second Power Transmission Project.


All loan funds provided under the project have been committed by subloan agreements through Stopanska Banka. Out of 43 subprojects financed under the project, 36 are completed, seven are under construction. Progress on the latter is satisfactory.

Loan 916 Naftagas Pipeline: US$59.4 million Loan of June 25, 1973; Effective Date: March 22, 1974; Closing Date: December 31, 1979.

The costs of equipment and civil works increased so that project costs were about 71 percent above the appraisal estimate. As a result of this and of a reallocation of priorities in the use of natural gas, the project has been redefined (Amendments to Loan 916-YU, May 13, 1976, R76-116). Phase I is a reduced version of the original plan. Phase II provides for a pipeline extension to link up with the pipeline to be constructed under the Sarajevo Air Pollution Control Project, for which additional Bank financing was obtained. Naftagas has obtained additional local currency financing required for Phases I and II. A delay of more than two and one-half years in project implementation has occurred as a result of the increased project costs and revision of the project. Construction started in late June 1976, and the project is scheduled for completion by end-1979.

Loan 990 Sixth Highway: US$30.0 million Loan of May 31, 1974; Effective Date: December 10, 1974; Closing Date: December 31, 1978.

All road sections are open to traffic. Two requests for changes in road alignments have been agreed in order to provide better service to two communities. Procurement of engineering and laboratory equipment has been contracted and payments are now being finalized. An EDI type training course is also being arranged in Yugoslavia in October 1978.
Loan 1012 Macedonia/Kosovo Industrial Credit: US$28.0 million Loan of June 21, 1974; Effective Date: December 19, 1974; Closing Date: December 31, 1978.

Progress has been satisfactory. The loan is fully committed. Loan disbursements have been accelerating after a slow start and are expected to soon catch up and even surpass appraisal estimates.

Loan 1013 Bosnia-Herzegovina/Montenegro Industrial Credit: US$22.0 million Loan of June 21, 1974; Effective Date: December 19, 1974; Closing Date: December 31, 1978.

The note under Loan 1012 above applies also to this loan.

Loan 1026 Fourth Railway: US$93.0 million Loan of July 10, 1974; Effective Date: February 12, 1975; Closing Date: June 30, 1979.

The project consists of the 1974-76 slice of the Railways' 1973-77 Investment Plan. Government efforts to combat inflation caused railway tariffs to lag behind inflation and gave rise to financial and administrative difficulties which, in turn caused substantial delays in project implementation. With tariff increases approved both in early 1977 and 1978 these problems have largely been resolved. Meanwhile, institutional developments, including improved investment planning and management, the formation of COIs and the signing of Social Agreements on railway and transport policies have been most encouraging.

Loan 1060 Port of Bar: US$44.0 million Loan of December 11, 1974; Effective Date: June 13, 1975; Closing Date: June 30, 1980.

In general the Project is progressing well. Except for railway facilities outside the port area and the grain silos, the project is expected to be completed by mid-1978, about six months behind schedule. The railway facilities and grain silos are scheduled for completion by end-1978 and end-1979, respectively.

Loan 1066 Dubrovnik Water Supply and Wastewater: US$6.0 million Loan of December 24, 1974; Effective Date: June 26, 1975; Closing Date: December 31, 1978.

Delays in preparation of final designs and tender documents have put construction about a year behind schedule. Services to the Bank financed Babin Kuk Hotel Complex (Loan 782-YU) were, however, completed in time for its initial operation and the remaining water supply component is nearing completion. Construction is progressing satisfactorily on the sewerage component.
Loan 1129 Agricultural Credit: US$50.0 million Loan of June 20, 1975; Effective Date: February 12, 1976; Closing Date: December 31, 1979.

The Project Operations Unit of Vojvodjanska Banka, established in March 1976, is working satisfactorily. Project operations have shown encouraging progress with respect to appraisal methodology and related aspects of institution building. Ninety percent of the loan has been committed. Disbursements are behind appraisal projections, given initial organizational and learning curve problems, delays in procurement, unfamiliarity of participating banks with withdrawal applications, timetaking translations and the time lag between commitments and disbursements. However, disbursements have accelerated during the last year.

Loan 1143 Seventh Highway: US$40.0 million Loan of July 18, 1975; Effective Date: March 30, 1976; Closing Date: June 30, 1979.

With the award of the last two contracts in Montenegro, work is now in progress on all the project roads of Serbia, Slovenia and Montenegro. The Serbian road sections have been substantially completed and are open to traffic. Work in Slovenia is on schedule but progress in Montenegro is somewhat slow owing to contract delays. Nevertheless, all road works should be completed by the loan closing date.

Loan 1173 Naftovod Oil Pipeline: US$49.0 million Loan of November 19, 1975; Effective Date: July 28, 1976; Closing Date: December 31, 1979.

Due to slower than anticipated progress of design and procurement it is estimated that a seven-month slippage in the completion of Phase I will occur, though it is expected that the balance of the Project will be completed on schedule. The revised cost estimates of the project indicate that there would be a cost overrun of about 27 percent because of required changes from original project components and increases in local costs. The Borrower is taking steps to obtain supplementary financing from various sources both foreign and local. The economic viability of the project remains sound. Upon review of the award of a site preparation contract, the Bank concluded that the contract was not awarded in accordance with the Bank's Guidelines for Procurement and the relevant portion ($470,000) that would have otherwise been eligible for disbursement was cancelled from the Loan.


The regional development study is finished and the report is being finalized. The flood control and water quality studies are underway after initial delays in selecting consultants. Construction of the Vrutci Dam has begun.
Construction is completed on the principal parts of the Cacak component, the remainder is well advanced. Construction is also underway in Titovo Uzice. Final designs of sewage treatment plants in Cacak are underway, and in Titovo Uzice, are dependent upon the recruitment of suitable foreign assistance to local consultants. The pilot irrigation components have been delayed pending the establishment of suitable monitoring arrangements. The creation of the Morava Region Water Community of Interest was delayed due to the longer than anticipated process of seeking agreement among all the Yugoslav parties concerned on the structure of the organization. Staffing has been strengthened in the water authorities in Cacak and Titovo Uzice and in the Morava Region Water Community of Interest.

Loan 1263 Sarajevo Water Supply and Sewerage: US$45.0 million Loan of June 8, 1976; Effective Date: November 9, 1976; Closing Date: June 30, 1981.

Major contracts for supply and installation of water pipes and sewers have been awarded and construction is underway. Prequalification of contractors for the sewage treatment plant was completed and design work is progressing satisfactorily.

Loan 1264 Sarajevo Air Pollution Control: US$38.0 million Loan of June 8, 1976; Effective Date: May 31, 1977; Closing Date: June 30, 1981.

Consultants for final designs and tender documents have been recruited and work on major tenders is underway. Contracts for supply and installation of gas distribution network and high-pressure loop-line have been awarded and mobilization is underway. Tendering for gas transmission line, Sarajevo-Zvornik, is underway.

Loan 1277 Second Industrial Credit: US$50.0 million Loan of June 14, 1976; Effective Date: October 29, 1976; Closing Date: December 31, 1980.

The portions of the loans to the Bosnian, Macedonian and Montenegrin banks have been progressing satisfactorily. The portion for the Kosovan bank, while being committed more slowly, is forecast to be fully committed by end-July 1978. Disbursements are slightly behind appraisal estimates.

Loan 1360 Metohija Multipurpose Water: US$54.0 million Loan of February 3, 1977; Effective Date: July 27, 1977; Closing Date: December 31, 1982.

Local consultants have been retained as project consultants and are proceeding with final designs on the project components and preparation of bidding documents. Two local construction contracts have been awarded and invitations for international tenders for the dam will be issued shortly.
Loan 1370 Montenegro Agriculture and Agro-Industries: US$26.0 million Loan of March 10, 1977; Effective Date: July 27, 1977; Closing Date: June 30, 1983.

Institutional arrangements have been completed, and the implementation of the project is proceeding on schedule. Tendering for ICB procurement for the winery and cold stores is in progress.

Loan 1371 Macedonia Agriculture and Second Agro-Industries: US$24.0 million Loan of March 10, 1977; Effective Date: July 27, 1977; Closing Date: June 30, 1982.

Sub-loans for four out of eleven agro-industrial sub-projects have been approved by the Borrower. Sub-projects in the individual sector are being processed. The hiring of procurement consultants is expected soon.

Loan 1377 Eighth Highway: US$56.0 million Loan of April 13, 1977; Effective Date: September 7, 1977; Closing Date: March 31, 1981.

This loan was declared effective September 7, 1977. All road contracts have been awarded and work is satisfactorily in progress. The contract for the Highway Master Plan for Kosovo has also been awarded. The studies on Road User Charges and Rail Costs are in progress.

Loan 1469 Second Power Transmission: US$80.0 million Loan of July 11, 1977; Effective Date: January 31, 1978; Closing Date: December 31, 1982.

The loan was declared effective January 31, 1978. Procurement has commenced. The proposed loan from the European Investment Bank was signed in November 1977 and local loan agreements have been executed.

Loan 1477 Second Agricultural Credit: US$75.0 million Loan of July 29, 1977; Effective Date: January 30, 1978; Closing Date: June 30, 1981.

The loan was declared effective January 30, 1978. All participating banks have identified the main investors and indicated that funds will be committed faster than under the first project.

Loan 1534 Fifth Railway: US$100 million Loan of April 13, 1978; Effective Date: August 31, 1978; Closing Date: June 30, 1982.

Terminal date for declaring effectiveness is August 31, 1978.

Loan 1535 Ninth Highway: US$80 million Loan of April 13, 1978; Effective Date: July 31, 1978; Closing Date: December 31, 1981.

Terminal date for declaring effectiveness is July 31, 1978.
ANNEX III

YUGOSLAVIA: INDUSTRIAL CREDIT PROJECT III

Supplementary Project Data Sheet

Section I: Timetable of Key Events

A. First Bank Mission to review project : June 1977
B. Departure of Appraisal Mission : September 26, 1977
C. Completion of Negotiations : March 14, 1978
D. Planned date of effectiveness : October 31, 1978

Section II: Special Bank Implementation Actions

None.

Section III: Special Conditions

A. Agreements negotiated:
   (i) domestic resources lent to social sector sub-projects receiving
       Bank funds will carry an interest rate of at least 6 percent, and
       to private sector sub-projects, at least 5 percent (para 62);
   (ii) sub-projects with total cost exceeding US$10 million equivalent
        will have to meet a cost per job criteria (US$40,000 per job or
        less--para 59).

B. Special conditions for Board presentation, effectiveness and disbursement:

None.